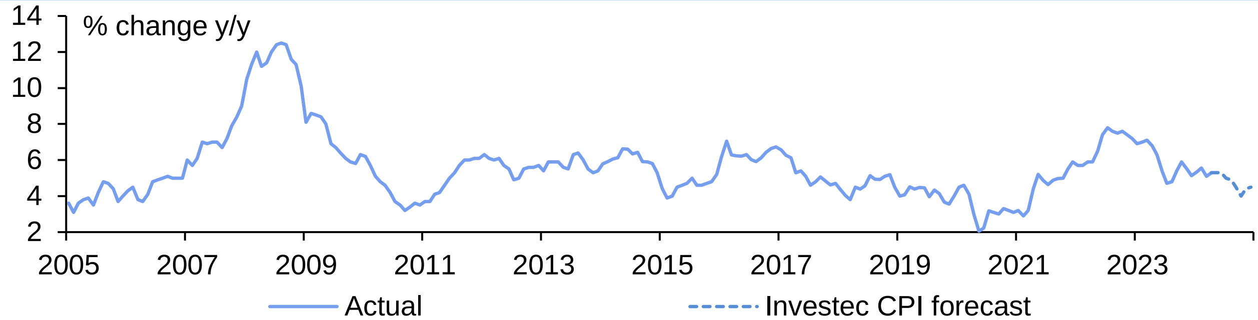
Investec

MPC update: SARB keeps rates unchanged at 8.25%

Thursday 18 July 2024

Figure 1: SA Consumer Inflation: history and forecasts



Source: Stats SA, SARB, Investec

- The SARB's monetary policy committee (MPC) kept the repo rate unchanged at 8.25% at its July meeting, in line with Investec's projection. The decision was however not unanimous, with four committee members choosing to keep rates on hold, while two members were in favour of a 25bp cut.
- Inflation has decelerated globally, however, "in most economies has yet to stabilise in line with targets", with wage and services price inflation proving sticky, "underpinned by resilient economic activity and low unemployment rates across major economies", according to the SARB.
- Domestically, the SARB now expects inflation to average 4.9% this year, from 5.1% projected at the last MPC meeting in May and they continue to see inflation steadying at the midpoint of the inflation targeting range over the medium-term. Moreover, Inflation expectations have moderated, with the SARB expecting "further progress as inflation slows, helping to re-anchor expectations firmly at 4.5%".
- Food and fuel price forecasts have been lowered, supported by a stronger rand. The implied starting point for the SARB's forecast is now R18.35/USD. Despite this, the balance of risks remain tilted to the upside. Specifically, administered prices remain an area of concern for the SARB, and they have lifted their forecast for electricity prices (from the last meeting). Additionally, they stressed that services price inflation is "uncomfortably above the mid-point".
- On the domestic growth front, despite a somewhat more favourable second quarter GDP outcome anticipated, supported by an improvement in electricity supply, the SARB's adjusted growth estimates "remain below longer-run historical averages, of about 2%". It continues to gauge the risks to the medium-term outlook to be balanced but has stressed there is "ample scope for structural reforms to lift growth further over the medium term".
- "Decisions of the MPC will continue to be data dependent, and sensitive to the balance of risks to the outlook."
- The next interest rate announcement is scheduled for the 19th September 2024.

Figure 2: SARB CPI inflation forecasts (% y/y)

	2024	2025	2026
SARB 18th July 2024	4.9	4.4	4.5
SARB 30th May 2024	5.1	4.5	4.5
SARB 27th Mar 2024	5.1	4.6	4.5
SARB 25th Jan 2024	5.0	4.6	4.5
SARB 23rd Nov 2023	5.0	4.5	4.5

Source: SA Reserve Bank

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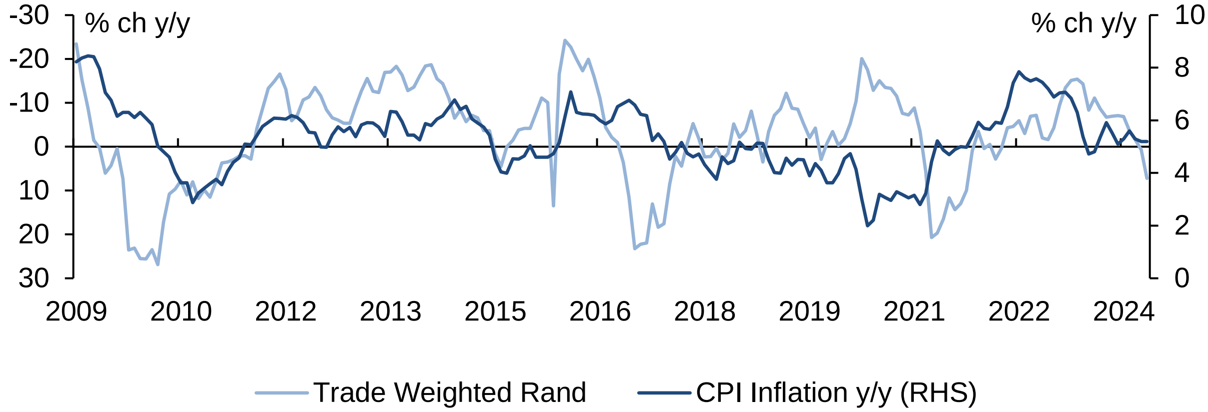
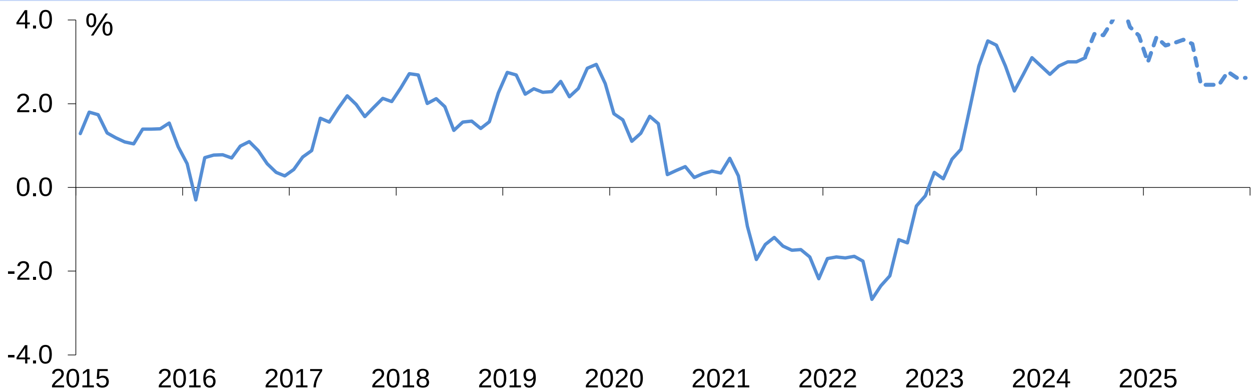
Figure 3: Trade weighted rand movements vs CPI inflation (both % change y/y)



Source: Stats SA, Iress

Figure 4: South Africa's real interest rate projections: (Investec CPI and repo forecasts)



Source: Investec, Iress

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Figure 5: Foreign sector assumptions

Percentage changes (unless otherwise indicated)	Actual		Forecasts		
	2022	2023	2024	2025	2026
1.Real GDP growth in South Africa’s major trading partner countries	3.7% (3.8%)	3.0% (2.9%)	2.7% (2.7%)	3.0% (3.0%)	3.1% (3.1%)
2.Output gap in South Africa’s major trading partner countries	0.1% (0.1%)	0.2% (0.2%)	-0.1% (-0.1%)	-0.1% (-0.1%)	0.0% (0.0%)
3.International commodity prices in US$ (excluding oil)	-0.9% (-0.9%)	-27.3% (-27.3%)	-6.5% (-10.4%)	-4.5% (-4.6%)	-1.7% (-1.4%)
4.Brent crude (US$/Barrel)	$100.4 ($100.4)	$82.6 ($82.6)	$84.0 ($84.0)	$81.0 ($81.0)	$80.0 ($80.0)
5.World food prices (US$)	15.0% (15.0%)	-13.8% (-13.8%)	-2.8% (-3.1%)	3.5% (3.1%)	1.5% (1.5%)
6.International consumer prices	7.4% (7.4%)	4.5% (4.5%)	2.6% (2.6%)	2.1% (2.1%)	2.0% (2.0%)
7.International policy interest rate	1.1% (1.1%)	3.9% (3.9%)	4.2 % (4.3%)	3.3% (3.4%)	2.2 % (2.2%)

Figures in blue represents the previous MPC assumption

Foreign Sector Assumptions

1. **Trading partner GDP growth:** is broadly determined via the Global Projection Model “GPM” which is adjusted to aggregate the GDP growth rates of South Africa’s major trading partners on a trade weighted basis. Individual projections are done for the four largest trading partners (euro area, China, United States and Japan), while the remaining trading partners are grouped into three regions: Emerging Asia (excluding China), Latin America and the Rest of Countries bloc. The assumption takes account of country specific “consensus” forecasts as well as regional growth prospects.
2. **Output gap:** as with GDP growth the output gap is determined via the GPM and is similarly adjusted. The output gap is driven by a combination of country-specific domestic factors, external factors, and financial-real linkages (beyond interest rate and exchange rate effects). Domestic factors include expectations of future demand and medium-term interest rates. External factors include exchange rate impacts on demand, direct spillovers through trade with trading partner countries, and foreign demand.
3. **International consumer prices:** are also broadly determined via the GPM, the index is an aggregate of the consumer price indices of the G3 countries (euro area, United States and Japan) weighted by their relative trade weights. Consumer prices are determined for each region discussed above by accounting for expected future price inflation, demand pressures, and pass-through from changes in the relevant exchange rate. Other institutional forecasts for international consumer prices are also considered.
4. **Commodity price index:** is a weighted aggregate price index of the major South African export commodities based on 2010 prices. The composite index represents the total of the individual commodity prices multiplied by their smoothed export weights. Commodity price prospects generally remain commensurate with global liquidity as well as commodity demand/supply pressures as reflected by the pace of growth in the trading partner countries.
5. **Brent crude oil price:** is expressed in US Dollars per barrel. The assumption incorporates the analysis of factors of supply, demand (using global growth expectations) and inventories of oil (of all grades), as well as the expectations of the US Energy Information Administration (EIA), OPEC and Reuters.
6. **World food prices:** is the composite food price index of the Food and Agriculture Organization of the United Nations (FAO) in US dollars. It is weighted via average export shares, and represents the monthly change in the international prices of a basket of five food commodity price indices (cereals, vegetable oil, dairy, meat and sugar). World food price prospects incorporate selected global institution forecasts for food prices as well as imbalances from the anticipated trend in international food supplies relative to expected food demand pressures.

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7. **International policy interest rate:** is again broadly determined via the GPM. Interest rates are an aggregate of the policy rates of the G3 countries (euro area, United States and Japan). They are individually determined by a "Taylor-type" monetary policy rule. The communications of the relevant central banks and other institutional forecasts are also considered.

Figure 6: Domestic sector assumptions

Percentage changes (unless otherwise indicated)	Actual 2022	Actual 2023	Forecasts 2024	Forecasts 2025	Forecasts 2026
1. Electricity price	10.7% (10.7%)	11.7% (11.7%)	13.5% (13.0%)	10.9% (10.5%)	9.0% (9.0)
2. Fuel taxes and levies	2.9% (2.9%)	3.1% (3.1%)	5.1% (5.8%)	3.3% (3.7%)	4.0% (4.0%)
3. Potential growth	0.6% (0.5%)	0.2% (0.1%)	1.2% (1.1%)	1.3% (1.2%)	1.7% (1.6%)
4. Inflation target midpoint	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)	4.5% (4.5%)

Source: SA Reserve Bank

Figures below the assumption in parentheses represents the previous MPC assumption

Domestic Sector Assumptions

1. **Fuel taxes and levies:** are the total domestic taxes and costs included in the price of fuel paid at the pump. They include the Road Accident Fund (RAF), the fuel levy, retail and wholesale margins, slate levy, and other minor levies. The two major taxes, which are set by the Minister of Finance in the annual budget, are the RAF and fuel levy. Income generated by the RAF levy is utilised to compensate third party victims of motor vehicle accidents while the fuel levy is used to provide funding for road infrastructure.
2. **Electricity price:** is an administered price measured at the municipal level with a weight of 3.75 per cent in the headline CPI basket. Electricity price adjustments generally take place in the months of July and August of each year, and the assumed pace of increase over the forecast period reflects the multi-year price determination (MYPD) agreement between ESKOM and NERSA with a slight adjustment for measurement at the municipal level.
3. **Potential growth:** the pace of potential growth is derived from the SARB's semi-structural potential output model. The measurement accounts for the impact of the financial cycle on real economic activity and introduces economic structure via the relationship between potential output and capacity utilisation in the manufacturing sector (South African Reserve Bank, Working Paper Series, WP/14/08).
4. **Inflation target midpoint:** is the middle of the official target range of 3 to 6 percent.

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